Plan Distributions

IRS Now Agrees IRS Claims May Be Secured by a Debtor's Interest in an ERISA Pension Plan

By MELANIE N. ASKA KNOX

The IRS has reconsidered its position on whether, for bankruptcy purposes, a debtor's interest in an ERISA-qualified plan is property of the bankruptcy estate. In a recent memorandum, the IRS now says yes, with certain qualifications.

The IRS Chief Counsel has reversed its former position and concluded that a debtor's interest in an ERISA-qualified pension plan is property of his bankruptcy estate. As a result, an IRS tax claim in bankruptcy may be secured to the extent of the value of the debtor's pension interests. [IRS Chief Couns Adv Mem 200041029 (April 11, 2000)]

BACKGROUND

Section 541(a)(1) of the Bankruptcy Code [11 USC] provides that property of the debtor's bankruptcy estate consists of all legal or equitable interests of the debtor in property as of the commencement of the bankruptcy case, except as provided in Section 541(b) and (c)(2) of the code. Section 541(c)(1) of the Bankruptcy Code further provides that the debtor's interest in property becomes property of the bankruptcy estate under Section 541(a), notwithstanding any restrictions on transfer, except as provided by Section 541(c)(2). Bankruptcy Code Section 541(c)(2) provides:

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

In *Patterson v. Shumate* [504 US 753 (1992)], the United States Supreme Court considered whether the debtor's interest in an employer pension plan that contained the anti-alienation provision required by Section 206(d)(1) of Title I of ERISA was included or excluded from the debtor's bankruptcy estate under Section 541 of the Bankruptcy Code. (*Patterson* did not involve bankruptcy claims of the IRS. The Chapter 7 trustee in that case was seeking to include in the bankruptcy estate the debtor's interest in his employer's qualified plan.) The Court held that the term "applicable nonbankruptcy law" in Section 541(c)(2) of the Bankruptcy Code was not limited to state law (and included ERISA and other federal law) and that the anti-alienation provision required under Section 206(d)(1) of Title I of ERISA was enforceable under nonbankruptcy law. The Court concluded that, under Section 541(c)(2) of the Bankruptcy Code, the debtor's interest in his employer's pension plan was excluded from his bankruptcy estate.

Under ERISA and federal tax law, anti-alienation provisions enforceable under ERISA against creditors generally are *not* enforceable against the IRS. [*See, e.g.,* Travelers Insurance Co v Ratterman, 96-1 USTC ¶ 50,143 (SD Ohio 1996) (while ERISA prevents ordinary creditors from attaching pension payments, courts have unanimously held that a federal tax lien or levy may be imposed on ERISA-qualified pension plans); Ameritrust Co, NA v Derakhshan, 830 F Supp 406 (ND Ohio 1993) (rejecting the assertion of the taxpayer's former spouse that a qualified domestic relations order is the only exception to ERISA's anti-alienation provisions, the district court held that the IRS may levy on funds in a taxpayer's IRA and Keogh account); In re Jacobs, 147 BR 106 (Bankr WD Pa 1992) (bankruptcy court held that federal tax lien may attach to the taxpayer's ERISA-qualified pension); In re Reed, 127 BR 244 (Bankr D Haw 1991) (ERISA anti-alienation provisions do not preclude enforcing a federal tax lien or collection on a judgment resulting from an unpaid tax liability); *see also* Shanbaum v United States, 32 F3d 180 (5th Cir 1994) (Fifth Circuit stated in dictum that a taxpayer's pension benefits under an ERISA-qualified plan are subject

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to levy despite the ERISA anti-alienation provision)] Because *Patterson* did not involve a claim of the IRS, it did not address the effect of a plan restriction on transfers that is not enforceable against a particular creditor, such as the IRS.

That question *was* addressed by Judge Teel, of the bankruptcy court for the District of Columbia in *In re Lyons* [178 BR 88 (Bankr DDC 1992)], who held:

> [T]he pension plan's provisions are not, within the language of Section 541(c)(2) [of the Bankruptcy Code], "enforceable under applicable nonbankruptcy law" with respect to the IRS. Under Section 541(c)(1) [of the Code], the debtor's pension rights thus remain property of the estate under Section 506(a) [of the Code] and the IRS has an allowed claim against the pension rights to the extent of their value. [In re Lyons, 148 BR at 94]

Judge Teel noted that this interpretation was "compelled" by the plain language of Section 541(c)(2) of the Bankruptcy Code, as well as by the following policy considerations:

> Outside bankruptcy, the IRS would have an enforceable lien against the debtor's vested right to receive a future stream of pension income despite spendthrift provisions in the pension plans. There is no evidence that in enacting Section 541(c)(2) [of the Bankruptcy Code] Congress intended the intervention of bankruptcy to alter the IRS's powers as a tax creditor. [In re Lyons, 148 BR at 93]

This same policy consideration—replicating within bankruptcy the result that would occur outside bankruptcy—was also recognized by the Supreme Court, which stated that its decision in *Patterson* "ensures that the treatment of pension benefits will not vary based on the beneficiary's bankruptcy status." [Patterson v Shumate, 504 US at 764]

Judge Teel revisited this issue in *In re Jones* [206 BR 614 (Bankr DDC 1997)], a case concerning whether a federal thrift savings plan (TSP) account is property of the bankruptcy estate. Like ERISA-qualified plans, TSP accounts are generally protected from alienation. Funds held in the federal thrift savings fund "may not be assigned or alienated and are not subject to execution, levy, attachment, garnishment or other legal process." [5 USC § 8437(e)(2)] The bankruptcy court in *Jones* recognized the unique position of the United States as a creditor in bankruptcy and held that the debtor's TSP account "would in effect have a split personality" by remaining property of the bankruptcy estate for purposes of federal tax claims even though it is not property of the estate for purposes of the other creditors' claims. [In re Jones, 206 BR at 621]

IRS INITIALLY REJECTED LYONS

By Memorandum dated July 16, 1996 [digested in G L Bull No 431], the IRS Chief Counsel took the position that the bankruptcy court's opinion in *Lyons* was legally unsound and, therefore, should not be followed. Several IRS District Counsel offices, as well as the Tax Division of the U.S. Department of Justice, questioned whether this rejection of *Lyons* was correct. On August 28, 1997, the IRS District Counsel office for Virginia and West Virginia requested the IRS Chief Counsel to reconsider its opinion.

IRS NOW ACCEPTS LYONS

In Chief Counsel Advice Memorandum 200041029 [April 11, 2000], the IRS Chief Counsel stated that it had reconsidered its former position and had concluded that the holding of the bankruptcy court for the District of Columbia in *Lyons* was correct.

The memorandum reflects the IRS's new position that the debtor's interest in ERISA-qualified pension plans and similar interests *are* property of the bankruptcy estate under Section 541 of the Bankruptcy Code, *but only for the benefit of the IRS*. The memorandum noted that under Section 506 (Determination of secured status) of the Bankruptcy Code, the IRS's claim is secured to the extent of the value of such interests. The memorandum stated the IRS's new view that the disparate treatment of the IRS and other creditors under Section 541 of the Bankruptcy Code is entirely appropriate and occurs elsewhere in the Bankruptcy Code. [IRS Chief Couns Mem 200041029 (Apr 11, 2000)]

Reflecting upon its former position on this issue, the IRS noted that *not* following *Lyons* leads to straightforward results, that is, ERISA-qualified plans and similar interests were excluded from the bankruptcy estate with respect to *both* the IRS *and* all other creditors. Because such interests were not property of the estate, they could not be used in determining the value of the IRS's secured claim. On the other hand, to the extent that the IRS had a tax lien that survived the bankruptcy, it could pursue collection outside bankruptcy. [IRS

Chief Coun Mem 200041029 (Apr 11, 2000)]

The IRS's new position, that *Lyons* is correct, is based upon the statutory framework of Section 541 (Property of the estate) and Section 506 (Determination of secured status) of the Bankruptcy Code and the U.S. Supreme Court's reasoning in *Patterson.* In Chief Counsel Memorandum 200041029, the IRS noted that the wording of Sections 541 and 506 of the Bankruptcy Code, on their face, supported the Bankruptcy Court's reasoning in *Lyons,* and there was nothing in the legislative history that would support a different result. Further, the IRS observed that there was no case law contrary to *Lyons.* Finally, the IRS noted that because, under *Lyons,* ERISA-qualified plans are property of the bankruptcy estate only for purposes of the IRS's claims, such property should be abandoned by the bankruptcy trustee pursuant to Section 554 (Abandonment of property of the estate) of the Bankruptcy Code. Section 554(a) provides that, after notice and a hearing, the bankruptcy trustee may abandon any property of the bankruptcy estate that is burdensome to or of inconsequential value and benefit to the estate. Alternatively, Section 544(b) provides that a party-in-interest can request that the bankruptcy court, on the same grounds, order the bankruptcy trustee to abandon the property.